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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 272

MOSES L. PARSHELSKY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

LAWRENCE A. BAKER,
Attorney for Petitioner
730 15th Street,
Washington, D. C.

Of Counsel:
HENRY RAVENEL
BAKER, SELBY & RAVENEL

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The undersigned, on behalf of the above-named petitioner, prays that a writ of certiorari issue to review the judgment (R. p. 89) of the United States Circuit Court of Appeals for the Second Circuit entered on May 21, 1943 remanding the cause to the Tax Court of the United States and increasing the deficiency in taxes of the petitioner for the calendar year 1938 over the amount determined by the Tax Court in its final order of redetermination (R. p. 34) entered May 14, 1942 said final order of the Tax Court having affirmed the claim of respondent for a deficiency against petitioner for the calendar year 1938 and denied the relief sought by petitioner in his petition.

THE OPINIONS BELOW.

The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. pp. 83-89) was promulgated May 5, 1943 and is reported in 135 F. (2d) 596. The findings of fact and opinion of the Tax Court of the United States were promulgated February 26, 1942 (R. pp. 22-33) and are reported in 46 B. T. A. 456.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals sought to be reviewed was entered on May 21, 1943. Jurisdiction to issue the writ requested is found in the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, C. 229, Sec. 1, 43 Stat. 938 (U. S. C. A. Title 28, Secs. 347-350).

STATUTE INVOLVED.

Revenue Act of 1938

"Sec. 22. Gross Income.

"(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

"(2) *Annuities, Etc.*—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income un-

der this title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph:"

"Sec. 113. *Adjusted Basis for Determining Gain or Loss.*

"(a) Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that

"(2) *Gifts After December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis so determined or the fair market value of the property at the time of the gift, whichever is lower. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

REGULATIONS INVOLVED.

Regulations 101

"Art. 22(b)(2)—2. Annuities.—Amounts received as an annuity under an annuity or endowment contract include amounts received in periodical installments, whether annually, semiannually, quarterly, monthly, or otherwise, and whether for a fixed period, such as a term of years, or for an indefinite period, such as for

life, or for life and a guaranteed fixed period, and which installments are payable or may be payable over a period longer than one year.* Such portion of each installment payment of an annuity shall be included in gross income as is not in excess of 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by 12 and multiplied by the number of months in respect of which the installment is paid. As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. The provisions of this article may be illustrated by the following examples:

"Example (1): A bought in 1935, for $50,000 consideration, a life annuity, payable in annual installments of $5,000. For the calendar year 1938 he would be required to include in gross income $1,500 of the $5,000 received during that year (3 per cent of $50,000), $3,500 being exempt. If A should live long enough to receive as exempt $50,000, then all amounts he receives thereafter under the annuity contract would be included in gross income.

"Example (2): A bought an annuity on October 1, 1938, paying $100,000 as consideration therefor. The annuity amounts to $7,824 a year, payable in semi-annual installments of $3,912, and on December 1, 1938, A received $1,304, the first payment under the contract being for a 2-month period. A shall include in his gross income for the calendar year 1938 the sum of $500, being 3 per cent of $100,000 (the consideration paid) divided by 12 and multiplied by 2 (the number of months in respect of which the installment was paid.)

"Example (3): A bought an increasing annuity on August 1, 1938, paying $40,000 as consideration there-

*Although the present statutory rule has been in effect for almost ten years, during which time respondents regulations have broadly defined "annuity" *as any periodic payment*, the propriety of the definition has been considered for the first time by the Tax Court in George H. Thornley, 2 T. C. #31 (June 25, 1943). The Tax Court holds in the cited case that "annuity" means a payment "computed with reference to the age and sex of the insured, or payee, and with reference to life or lives":

for. The annuity amounts to $1,000 a year for the first year, $2,000 a year for the second year, and $3,000 a year thereafter, payable in quarterly installments. A received the first quarterly installment on November 1, 1938, amounting to $250. A shall include in his gross income for the calendar year 1938 the sum of $250, being such portion of the installment as is not in excess of 3 per cent of $40,000 (the consideration paid) divided by 12 and multiplied by 3 (the number of months in respect of which the installment was paid.)"

"Art. 113(a)(2)—1. Property transmitted by gift after December 31, 1920.—(a) Property included.—Sec. 113(a)(2) applies to all property acquired after December 31, 1920, by gift, whether by transfer in trust or otherwise. It does not apply to property acquired by (1) devise or bequest (see section 113(a)(5); or (2) an instrument which, under section 113 (a)(5), is to be treated as though it were a will.

Section 113(a)(2) applies to all gifts of whatever description; whether by a transfer in trust or otherwise; whenever and however made, perfected, or taking effect; whether in contemplation of or intended to take effect in possession or enjoyment at or after the donor's death; whether subject at any time to any change through the exercise of any power of appointment, revocation or otherwise; or whether made by means of the exercise (other than by will) of a power of appointment or revocation, or any other power."

STATEMENT OF THE CASE.

Section 22(b)(2) of the Revenue Act of 1938 (the Revenue Acts of 1934 and 1936 and the Internal Revenue Code are the same) requires the recipient of annuity payments to include annually in his gross income 3 per cent of the "aggregate premiums or consideration paid" for such annuity. When the amounts received in excess of amounts previously reported as gross income have equalled the aggregate premiums or consideration paid, the recipient is required to include all annuity receipts in gross income.

In December 1934 and January 1935 petitioner, and his brother Isaac, each purchased from insurance companies

for single premiums, annuity contracts which named the other as annuitant, guaranteed a return to the purchaser and his estate of all unused premiums in annual payments if the annuitant predecessed the purchaser and to the estate of the annuitant such unused premiums if the purchaser predeceased the annuitant. The aggregate premiums or consideration paid by each was $200,000. (R. pp. 23, 25.) The total paid by both was $400,000.

Isaac died March 18, 1935, before receiving any payments. (R. p. 24.)*

As the survivor of Isaac, the deceased annuitant, petitioner receives annually the payments guaranteed to him in refund of the premiums paid by him for the contracts purchased by him; he also receives the "annuity" payments provided in the contracts purchased by his brother, Isaac. Such payments aggregate $29,370.50. (R. p. 24.) Upon his death petitioner's estate will be paid the unexhausted premiums paid for all of the contracts.

The aggregate premiums or consideration paid by petitioner for the annual amounts he is now receiving is $200,000; 3 per cent of $200,000 is $6,000. The aggregate premiums or consideration paid by petitioner and his brother Isaac for the annual payments petitioner is now receiving is $400,000; 3 per cent of $400,000 is $12,000. Under Section 22(b)(2) of the Revenue Act of 1938, petitioner should be required to include as income in his income tax

*If both the petitioner and his brother, Isaac, had continued to live and receive payments under the contracts the respondent would certainly agree with the petitioner that each annuitant would be taxable on a maximum annual income of $6,000.00, being 3 per cent of the aggregate premiums paid by each; nor would the respondent suggest that the original premiums paid should be segregated so as to treat only a part thereof as applicable to the 3 per cent measure established by Congress for the taxation of annuity income. However, Isaac died March 18, 1935, before receiving any payments. (R. p. 24.) The mere fact of his death leads the courts below to depart from the basis which would have obtained had he lived and the question is thereby raised whether the death of the annuitant can change the predetermined basis of aggregate premiums or considerations paid.

return a minimum of $6,000 or a maximum of $12,000 annually until the amounts excluded exceed the premiums paid by him ($200,000) or by him and Isaac ($400,000). (Judge Swan, in his dissenting opinion (R. pp. 86-89), was of the opinion that the measure of petitioner's annual income is the total premiums paid by him and his brother ($400,000) and that petitioner's annual income from the contracts is $12,000.).

The Tax Court required petitioner to include in his income $19,605.30 made up of $5,214.80 (being 3 per cent of $173,826.72, held to have been the cost to him of the straight annuities provided by Isaac's contracts) and $14,390.50 (being the total payments received from the contracts purchased by him). The Tax Court reasoned that the right to receive the payments under the contracts purchased by petitioner had been transferred to him by Isaac for a consideration of $26,173.28, and he having received under those contracts in prior years more than $26,173.28, all of the annual payments are income under the last sentence of Section 22(b)(2).* The total payments received by petitioner in years prior to 1938 were $84,449.50 (R., p. 24), but his tax liability for 1935, 1936, and 1937 has not yet been finally redetermined by the Tax Court although a petition is pending for that purpose.

The opinion of the Circuit Court of Appeals will require petitioner to include in his income $19,690.06, increasing his tax liability over the amount determined by the Tax Court, made up of $5,299.56 (being 3 per cent of $176,652.23, this increased amount having been held by the Circuit Court to

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*The sentence reads: "In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) of this paragraph."

Judge Swan in his dissent (R. pp. 86-89) denied that either petitioner or his brother had made a transfer to the other and, therefore, held this portion of the statute to be inapplicable.

have been the cost of straight annuities received by petitioner) and $14,390.50 (being the total payments received under the contracts purchased by him).

The Tax Court's basic ultimate error resulted from these erroneous conclusions:

(1) Merely because the contracts were reciprocal and were purchased by agreement the Tax Court held that they should be transposed and that petitioner was the purchaser of those bought by Isaac and Isaac was the purchaser of those bought by petitioner.

(2) Although the documentary evidence clearly showed and the Tax Court found that all of the contracts were purchased for single premiums it held that such premiums could be broken down and segregated to the various benefits under the contracts, i.e.,

   (a) Straight annuity;

   (b) Benefits after the death of the annuitant;

   (c) Refund of the unused premium either to the estate of the annuitant or the beneficiary depending on which survived.

This breakdown was based on the testimony of an expert. He completely failed, however, to testify that the after-death benefits or the refund provisions could have been purchased separately for the segregated cost. On cross-examination he admitted that insurance companies would not sell contracts providing only for such after-death benefits at the segregated cost which he attributed to those benefits. He did not and could not say that petitioner purchased for either $26,173.28 (the Tax Court's figure) or $23,347.77 (the Circuit Court's figure) the right to receive $200,000 or an amount in excess thereof to be produced by the contracts purchased either by himself or Isaac. (Statement of evidence R., pp. 51-58.)

(3) The third error was that "aggregate premiums or consideration paid" refers to and includes only those paid by the recipient of the annuity. This resulted in completely ignoring the $200,000 paid by Isaac for the contracts purchased by him and taxation of petitioner on that capital sum.

The majority opinion by Judge Frank of the Circuit Court, without citation of authority, increases the amount to be reported annually by petitioner as income and his consequent tax liability. On the one hand it says "There was substantial evidence to support the Tax Board's findings in general." On the other hand, it apparently disagrees with the Tax Court's conclusion that the purchases should be transposed and in its ultimate conclusion contents itself with restating the theoretical breakdown of the single premiums paid by petitioner for the contracts. It also completely ignores the fact that Isaac paid $200,000 for the contracts which he purchased and from which petitioner is receiving payments, with the result petitioner is taxed on the return of that capital sum. (R., pp. 83-87.)*

To use the words of Judge Swan's dissenting opinion both the Tax Court and the Circuit Court indulged in "fictions and unrealities" (R., p. 88) which, although resulting in increased revenue to the Government over the years ignores the fact that neither petitioner nor Isaac transferred anything to the other and that the aggregate premiums or consideration paid by petitioner was $200,000 and the aggregate premiums or consideration paid by petitioner and Isaac was $400,000.

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* As appears from the statement of evidence petitioner offered in the Tax Court proof that respondent has included in the estate of Isaac and collected an estate tax on the $200,000 which Isaac paid for his contracts on the ground that they were transferred by Isaac to petitioner in contemplation of death or to take effect in possession and enjoyment at death.

QUESTIONS PRESENTED.

1. What is the meaning of the phrase in the Revenue Act of 1938 "amounts received as an annuity"? Does it include all periodic payments or only those computed with reference to age, sex and mortality?

2. What "aggregate premiums or consideration" did petitioner pay for the "amounts" received by him "as an annuity" during 1938?

3. Do the words "aggregate premiums or consideration paid" in Section 22 (b)(2) of the 1938 Act refer only to those paid by the recipient of an annuity, or to those paid for the the annuity by another, where the recipient is not the purchaser?

4. Is not this petitioner entitled after meeting his 3 per cent obligation to receive tax free the consideration paid by him and his brother for the annuity contracts? If not, he is then subject to tax on a capital expenditure of $200,000.

5. If this petitioner is not entitled, after meeting his 3 per cent obligation, to receive tax free the consideration paid by him and his brother, is he not at least entitled to recover tax free the capital he invested plus the commuted value of contracts taxed as part of his brother's estate?

6. Can a single premium paid for an annuity contract be segregated theoretically to the various benefits provided by the contract when the statute fixes, as the measure of the taxable income, the "aggregate premiums or consideration paid?"

REASONS FOR GRANTING THE WRIT.

1. The meaning of the phrase "amounts received as an annuity" (the phrase has been included in all Revenue Acts since that of 1934 and is now part of the Code) is an important question of Federal law which has not been but should be decided by this Court. Petitioner argued below

that as to three of the contracts actually purchased by him he cannot receive any amount in excess of his cost and therefore the payments thereunder represent a return of his capital. He also argued below that if the purchases should be transposed he is restricted to receiving under the terms of three of the contracts purchased by his brother the cost thereof to his brother and the payments received under those contracts represent a return of capital. Both of the lower Courts ignored these contentions and in effect held that any periodic payment is an annuity. Since the opinion of the Circuit Court was rendered in this case the Tax Court has held in the case of George H. Thornley (June 25, 1943) 2 T. C. #31 that "amounts received as an annuity" . . . means amounts "computed with reference to the age and sex of the insured, or payee, and with reference to life or lives." In the Thornley case the Tax Court properly refused to subject periodic payments not computed with reference to life or lives to the annuity rule and permits a recovery of the entire cost before subjecting any of the payments to tax. It correctly holds that a contrary conclusion would result in taxing a return of capital. Unless this court grants relief and reverses the judgment of the courts below this petitioner will be taxed on a return of capital.

2. The measure of the taxable income resulting from annuity payments under Section 22(b)(2) of the Revenue Act of 1938, prior Revenue Acts, and the Internal Revenue Code is an important question of Federal law which has not been but should be decided by this Court.

3. The measure of the taxable income to the recipient of annuity payments *who has not paid* the premiums or consideration for the annuity contract is an important question of Federal law which has not been but should be decided by this Court. The opinions of the Courts below are in direct conflict with the only other published opinion on the subject, i.e., *Title Guaranty & Trust Co.* v. *Commissioner,* 40 B. T. A.

475. The opinions of the Courts below are also in direct conflict with the published rulings of the respondent with respect thereto.*

4. The propriety of segregating a single premium paid for an annuity contract into component parts theoretically representing the cost of the various benefits provided by the contract is an important question of Federal law which has not been but should be decided by this Court. The opinions below will, if generally applied, reduce the revenue from annuities because in determining the amount of income to be reported by an annuitant or after death beneficiary the three per cent will be applied *not* to the aggregate premiums or consideration paid for the contract *but only to the theoretical cost* of the particular benefit enjoyed which will always be less than the total cost. This is obviously contrary to the congressional intention implicit in the words "*aggregate* premiums or consideration paid."

5. The opinions of the Courts below are in conflict at least indirectly with the opinion of this Court in *Helvering* v. *Le Gierse,* 312 U. S. 531, wherein this Court refused to

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*Mertens Law of Federal Income Taxation states (Vol. 1, pp. 284, 285): "In some of these cases the language used raises doubt as to whether under this provision the consideration for the annuity must be paid by the beneficiary. Department rulings indicate, however, that such is not necessarily the case and that a beneficiary under an annuity contract may be entitled to the benefits of this section even though consideration is paid by another."

Mertens cites I. T. 3322, C. B. 1939-2, p. 177; I. T. 3140, C. B. 1937-2, p. 62; I. T. 3033, C. B. XV-2, p. 131. In the last mentioned respondent ruled: "under the provisions of the Revenue Act of 1932 * * * and subsequent revenue acts, a beneficiary under an annuity contract is entitled to recover tax free the consideration paid for the annuity regardless of the fact that the consideration was paid by one other than the annuitant (I. T. 2635, C. B. XI-2, p. 63)." In I. T. 3322, C. B. 1939-2, p. 177, the taxpayer received payments under a refund provision that was irrevocable which it was held to be acquired as a gift inter vivos. The payments were held tax free until the entire cost to the donor was recovered.

See also I. T. 3077 C. B. 1937-1, p. 136; I. T. 3092 C. B. 1937-2, p. 61.

consider as separate, premiums paid for an annuity contract and a life insurance policy, where the amount of each premium depended upon the other, and neither contract would have been issued unless the other had been purchased. It is clear in this case that the theoretical premiums as segregated by the Courts below to the various contract features were not paid as such and no proof was or could be offered that the contract benefits could have been purchased separately at those costs. In the Le Gierse case this Court said:

> "The two contracts must be considered together. To say they are distinct transactions is to ignore actuality," * * *

Circuit Judge Swan in his dissent below (R., p. 88) said:

> "Similarly in the case at Bar I see no reason for indulging in fictions and unrealities merely to augment taxes."

Respectfully submitted,

LAWRENCE A. BAKER,
Attorney for Petitioner.